

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

APPLIED ELASTOMERICS, INCORPORATED, a
California corporation,

Plaintiff,

v.

Z-MAN FISHING PRODUCTS, INCORPORATED,
a South Carolina corporation,

Defendant.

No. C 06-2469 CW

ORDER DENYING
DEFENDANT'S
MOTION FOR
PARTIAL JUDGMENT
ON THE PLEADINGS
AND GRANTING IN
PART PLAINTIFF'S
MOTION TO DISMISS
COUNTERCLAIMS

AND RELATED COUNTERCLAIMS.

Defendant Z-Man Fishing Products, Inc. moves for partial judgment on the pleadings in its favor with respect to Plaintiff Applied Elastomerics, Inc.'s claim for a contractual trebling penalty. Plaintiff opposes the motion and, in a separate motion, moves to dismiss the second, third, fourth, fifth, sixth and seventh causes of action in Defendant's third amended counter-complaint. Although Defendant opposes that motion, it agrees to the dismissal of its second, third, fifth, sixth and part of its

1 seventh counterclaims. The matter was decided on the papers.
2 Having considered all of the papers filed by the parties, the Court
3 denies Defendant's motion and grants Plaintiff's motion in part and
4 denies it in part.

5 BACKGROUND

6 As explained in the Court's prior orders, Plaintiff invents
7 and patents certain chemical compositions, composites and articles
8 made from these compositions and composites. Plaintiff
9 commercializes its technology by licensing its patents, proprietary
10 technology and know-how to third parties. Plaintiff's president,
11 John Chen, handles all of the business aspects of commercializing
12 the technology he invents and develops. Defendant develops and
13 manufactures fishing lure components and fishing lures for major
14 lure manufacturers. In 2001, Mike Shelton, Defendant's Vice
15 President of Marketing and Sales and Director of Technology,
16 contacted Mr. Chen concerning a fishing lure product that he was
17 trying to develop, the "superworm."¹

18 According to Plaintiff's complaint, the parties entered into a
19 license agreement in July, 2001. The agreement is governed by
20 California law. Under the agreement, Defendant must make one of
21 two types of royalty payments on a quarterly basis: either a
22 "running royalty," which is calculated as a percentage of
23 Defendant's net revenues from sales of products using Plaintiff's
24 technology or patents, or a "minimum royalty." Section 5.7 of the
25 agreement further provides:

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27 ¹The factual background of this case is described in the
28 Court's August 10, 2006 and November 8, 2006 orders.

1 In addition to the interest provision of this Section as to
2 late royalty payments, the following shall be the penalty due
3 to fraud or false statements in connection with any unpaid
4 royalties for which AEI has provided Company with notification
5 and which remain uncorrected or unpaid (with interest) under
6 this Section for more than thirty (30) days from the date of
7 such notification: A penalty of three (3) times the amount of
royalty underpayment due to fraud or false statements which are
unreported and unpaid falling within the term of this Agreement
which penalty shall be considered as the sole compensation and
damages for the unreported infringing sales and such sales
shall be treated as infringing sales in accordance with 35
U.S.C. § 284.

8 In June, 2004, Defendant wrote to Plaintiff stating that it
9 did not intend to pay any more royalties. According to Defendant,
10 it did not owe any royalties under the agreement because it was not
11 manufacturing and selling products that infringed the patent rights
12 or used Plaintiff's technology. Plaintiff disagreed and sent
13 Defendant numerous letters seeking to collect the minimum royalties
14 it believed it was owed. Defendant refused to pay, again claiming
15 that it did not owe Plaintiff any minimum royalties.

16 On April 7, 2006, Plaintiff brought this suit for breach of
17 contract and breach of the covenant of good faith and fair dealing.
18 Plaintiff seeks to recover the minimum royalties it alleges it is
19 owed under the agreement; it does not seek to recover any running
20 royalties. In addition, it alleges that, pursuant to section 5.7
21 of the agreement, the amount it is owed is subject to trebling
22 because Defendant's failure to pay the minimum royalties was based
23 on its false statements that it did not owe the minimum royalties.

24 Defendant filed a motion to dismiss for lack of personal
25 jurisdiction, which the Court denied. On July 13, 2006, Defendant
26 filed a complaint against Plaintiff in the District of South
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1 Carolina; that case has been transferred to this district.²

2 Defendant filed its answer and twelve counterclaims, nine of
3 which the Court dismissed with leave to amend. Defendant then
4 filed its first amended counter-complaint, which contained five
5 causes of action: (1) fraud; (2) negligent misrepresentation;
6 (3) restitution; (4) breach of the covenant of good faith and fair
7 dealing and (5) declaratory relief. With Plaintiff's stipulation,
8 Defendant filed a second amended counter-complaint on January 3,
9 2007. The second amended counter-complaint contained only two
10 claims for relief: breach of the covenant of good faith and fair
11 dealing and declaratory judgment of no breach of contract for
12 failure to pay royalties because of non-infringement.

13 Plaintiff moved to dismiss Defendant's second amended counter-
14 complaint. The Court granted Plaintiff's motion, dismissing the
15 breach of covenant cause of action with leave to amend and
16 dismissing the breach of declaratory judgment cause of action
17 without leave to amend. The Court instructed Defendant to include
18 in its third amended counter-complaint any viable claims it wished
19 to pursue from the transferred South Carolina action.

20 On March 15, 2007, Defendant filed its third amended counter-
21 complaint, which contained seven causes of actions: (1) breach of
22 the covenant of good faith and fair dealing; (2) declaratory
23 judgment -- non-infringement; (3) declaratory judgment --
24 invalidity; (4) declaratory judgment -- co-inventorship;
25 (5) constructive trust; (6) conversion; and (7) restitution --

26
27 ²The Court related and consolidated the transferred case to
28 this case.

1 unjust enrichment. Shortly thereafter, Plaintiff covenanted not to
2 sue Defendant on the challenged patents.

3 LEGAL STANDARD

4 I. Judgment on the Pleadings

5 Federal Rule of Civil Procedure 12(c) provides, "After the
6 pleadings are closed but within such time as not to delay the
7 trial, any party may move for judgment on the pleadings." Judgment
8 on the pleadings is proper when the moving party clearly
9 establishes on the face of the pleadings that no material issue of
10 fact remains to be resolved and that it is entitled to judgment as
11 a matter of law. Hal Roach Studios, Inc. v. Richard Feiner & Co.,
12 Inc., 896 F.2d 1542, 1550 (9th Cir. 1990). In considering a motion
13 for judgment on the pleadings, the Court must accept the
14 allegations of the non-moving party as true; the allegations of the
15 moving party which have been denied are assumed to be false. Id.
16 The Court, however, may consider facts that "are contained in
17 materials of which the court may take judicial notice." See
18 Heliotrope General, Inc. v. Ford Motor Co., 189 F.3d 971, 981 n.18
19 (9th Cir. 1999) (quoting Barron v. Reich, 13 F.3d 1370, 1377 (9th
20 Cir. 1994)).

21 II. Motion to Dismiss

22 A motion to dismiss for failure to state a claim will be
23 denied unless it is "clear that no relief could be granted under
24 any set of facts that could be proved consistent with the
25 allegations." Falkowski v. Imation Corp., 309 F.3d 1123, 1132 (9th
26 Cir. 2002) (citing Swierkiewicz v. Sorema N.A., 534 U.S. 506
27 (2002)). Dismissal of a complaint can be based on either the lack
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1 of a cognizable legal theory or the lack of sufficient facts
2 alleged under a cognizable legal theory. Balistreri v. Pacifica
3 Police Dept., 901 F.2d 696, 699 (9th Cir. 1990).

4 All material allegations in the complaint will be taken as
5 true and construed in the light most favorable to the plaintiff.
6 NL Indus., Inc. v. Kaplan, 792 F.2d 896, 898 (9th Cir. 1986).

7 A complaint must contain a "short and plain statement of the
8 claim showing that the pleader is entitled to relief." Fed. R.
9 Civ. P. 8(a). "Each averment of a pleading shall be simple,
10 concise, and direct. No technical forms of pleading or motions are
11 required." Fed. R. Civ. P. 8(e).

12 DISCUSSION

13 I. Defendant's Motion for Partial Judgment on the Pleadings

14 Defendant seeks judgment on the pleadings that Plaintiff
15 cannot recover on its claim for a trebling penalty under the
16 agreement. It argues that the "fraud or false statements" trigger
17 for the trebling provision applies only to fraud or false
18 statements by the licensee regarding "running," or sales-based,
19 royalties, not minimum royalties. Emphasizing one portion of
20 section 5.7, Defendant contends that this is the only possible
21 interpretation of the clause because sales, whether infringing or
22 not, are not relevant to the calculation of minimum royalties: "A
23 penalty of three (3) times the amount of royalty underpayment due
24 to fraud or false statements which are unreported and unpaid
25 falling within the term of this Agreement which penalty shall be
26 considered as the sole compensation and damages for the unreported
27 infringing sales."

1 Plaintiff, however, emphasizes a different portion of section
2 5.7:

3 In addition to the interest provision of this Section as to
4 late royalty payments, the following shall be the penalty due
5 to fraud or false statements in connection with any unpaid
6 royalties for which AEI has provided [Z-Man] with written
notification and which remain uncorrected or unpaid (with
interest) under this Section for more than thirty (30) days
from the date of such notification. . . .

7 In particular it emphasizes "with any unpaid royalties." Plaintiff
8 argues that the only way to interpret this section is to find that
9 the trebling provision applies to any unpaid royalties, which
10 includes both minimum and running royalties.

11 The Court need not at this time determine which party's
12 interpretation is correct.³ Even if Defendant is correct that the
13 language of the contract supports its interpretation, not
14 Plaintiff's, the Ninth Circuit requires that the Court give
15 Plaintiff "an opportunity to present extrinsic evidence as to the
16 intention of the parties in drafting the contract." Trident Center
17 v. Connecticut General Life Ins. Co., 847 F.2d 564, 570 (9th Cir.
18 1988). As explained in A. Kemp Fisheries, Inc. v. Castle & Cooke,
19 Inc., Bumble Bee Seafoods Div., 852 F.2d 493, 497 n.2 (9th Cir.
20 1988), under Trident, "courts may not dismiss on the pleadings when
21 one party claims that extrinsic evidence renders the contract
22 ambiguous." Rather, the case must proceed beyond the pleadings so
23 that the court may consider the evidence and if, "after considering
24 the evidence, the court determines that the contract is not

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26 ³Nor will the Court address Defendant's suggestion that the
27 trial date and other dates be delayed. If Defendant desires to
change the trial date and other dates in case management schedule,
it must file a motion to do so.

1 reasonably susceptible to the interpretation advanced, the parol
2 evidence rule operates to exclude the evidence." Id.

3 Because extrinsic evidence cannot be considered on a motion
4 for judgment on the pleadings, Defendant's motion cannot be
5 granted. Defendant fails to establish clearly on the face of the
6 pleadings that no material issue of fact remains to be resolved
7 concerning the trebling penalty and that it is entitled to judgment
8 as a matter of law.

9 II. Plaintiff's Motion

10 As noted above, Plaintiff moves to dismiss the second, third,
11 fourth, fifth, sixth and seventh causes of action in Defendant's
12 third amended counter-complaint. Defendant agrees to dismiss its
13 second, third, fifth and sixth counterclaims. Although Defendant
14 states in the introduction of its opposition that it agrees to
15 dismissal without prejudice of its second and third counterclaims
16 and dismissal with prejudice of its fifth and sixth claims, in its
17 conclusion it states that it agrees to dismissal without prejudice.

18 The Court dismisses the second and third without prejudice;
19 the fifth and sixth counterclaims are dismissed with prejudice. As
20 Plaintiff notes, under California law, Defendant's fifth
21 counterclaim for constructive trust is a remedy, not an independent
22 cause of action, mandating dismissal with prejudice. See
23 Stansfield v. Starkey, 220 Cal. App. 3d 59, 76 (1990). And
24 Defendant seemingly concedes that the statute of limitation ran on
25 its conversion claim before it first asserted that claim in the
26 South Carolina action.

1 A. Fourth Counterclaim

2 In its opposition, Defendant clarifies that its fourth
3 counterclaim seeks to correct inventorship under 35 U.S.C. § 256
4 and nothing more. In response, Plaintiff withdraws its motion to
5 dismiss the claim to the extent it relates to the three issued
6 patents. It persists in its motion to dismiss the fourth
7 counterclaim to the extent it relates to the pending patent that,
8 according to Defendant's counterclaim, the Patent and Trademark
9 Office is about to issue.

10 Section 256 authorizes judicial resolution of co-inventorship
11 contests over issued patents, not over patents that have not yet
12 issued at the time the complaint is filed. Eli Lilly and Co. v.
13 Aradigm Corp., 376 F.3d 1352, 1357 n.2 (Fed. Cir. 2004). The
14 Federal Circuit has explained that the subsequent issuance of a
15 patent after the complaint was filed cannot cure the jurisdictional
16 defect. GAF Building Materials Corp. v. Elk Corp. of Dallas, 90
17 F.3d 479, 483 (Fed. Cir. 1996). Because the Court has no
18 jurisdiction over the disputed inventorship of a pending patent
19 application, even if that application then issues as a patent after
20 the complaint was filed, the Court dismisses Defendant's claim
21 concerning Patent Application No. 10/199,362. Defendant may seek
22 to amend its complaint if a patent has issued based on that
23 application.

24 B. Seventh Counterclaim

25 Also in its opposition, Defendant explains that its seventh
26 counterclaim for unjust enrichment is based on two theories:
27 (1) restitution for Plaintiff's conversion of Defendant's
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1 proprietary information and (2) restitution of money paid by
2 Defendant to Plaintiff to the extent that a contract is not found
3 to have existed between the parties. Defendant states that,
4 because it agrees to dismiss its conversion claim, it also agrees
5 to dismiss its restitution claim based on that theory. With regard
6 to its second theory, however, Defendant argues that it has stated
7 a valid counterclaim that should not be dismissed. It
8 acknowledges, however, that it has not previously plead this theory
9 in this action or in the transferred South Caroline action.

10 As Plaintiff points out, Defendant did not have the Court's
11 permission to amend its counter-complaint to include a claim that
12 was never before raised. Nonetheless, although the Court dismisses
13 Defendant's claim for unjust enrichment based on its first theory,
14 it will not dismiss Defendant's unjust enrichment claim based on
15 its second theory. Defendant has asserted throughout this
16 litigation its theory that a contract did not exist between the
17 parties. Plaintiff will not be prejudiced by allowing Defendant to
18 plead an unjust enrichment claim based on its theory of restitution
19 of money paid by Defendant to Plaintiff to the extent that a
20 contract is not found to have existed between the parties.

21 CONCLUSION

22 For the foregoing reasons, the Court DENIES Defendant's Motion
23 for Partial Judgment on the Pleadings (Docket No. 110).⁴

24 _____
25 ⁴Defendant's motion for judicial notice (Docket No. 111) is
26 GRANTED. Defendant's motion to file a sur-reply (Docket No. 122)
27 is DENIED. As Plaintiff notes in its opposition, the proposed
sur-reply addresses issues that Defendant should have, and could
have, addressed in its opposition.

1 Plaintiff's Motion to Dismiss (Docket No. 102) is GRANTED IN PART
2 AND DENIED IN PART. Defendant's second and third claims are
3 dismissed without prejudice; the fifth and sixth claims are
4 dismissed with prejudice. The portion of Defendant's fourth claim
5 to correct inventorship with respect to Patent Application
6 No. 10/199,362 is dismissed without prejudice. Defendant's seventh
7 claim for unjust enrichment based on its conversion claim is
8 dismissed with prejudice. Defendant's seventh claim for unjust
9 enrichment based on Defendant's theory that the parties never
10 formed a contract, however, is not dismissed; Defendant can go
11 forward with that counterclaim.

12 Currently, the dispositive motion cut-off date is set for
13 Friday, August 31, 2007 at 10:00 a.m.; that date is continued to
14 Thursday, September 6, 2007 at 2:00 p.m. The pretrial conference,
15 currently scheduled for Friday, November 2, 2007, is continued to
16 Tuesday, November 6, 2007 at 2:00 p.m.

17 IT IS SO ORDERED.

18
19 Dated: 6/1/07



CLAUDIA WILKEN
United States District Judge